

**Testimony on Protecting the Public Interest in  
Public Private Partnerships**

**to the  
Subcommittee on Highways and Transit  
of the  
House Committee on Transportation and  
Infrastructure**

**by  
Frank J. Busalacchi  
Secretary, Wisconsin Department of  
Transportation**

**Tuesday, February 13, 2007**

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Mr. Chairman and members of the Committee, my name is Frank Busalacchi and I am the Secretary of the Wisconsin Department of Transportation. I am honored to have this opportunity to comment on how the public interest should be addressed as state governments look at Public Private Partnerships – or P3s – as one of several options to augment their transportation revenues.

I am also a member of the National Surface Transportation Policy and Revenue Study Commission – the National Commission. The National Commission is working to construct a new 50-year vision for our nation's transportation system. We are in the midst of our deliberations and my comments do not represent the views of the Commission. Every Commissioner is working to keep an open mind on all issues.

State DOTs are all stretched to find adequate revenues to fund their projects. The daily news stories cover the projects that each and every state envisions but lacks the funding to build. In Wisconsin, a legislative committee estimates our unmet transportation needs to be in the range of \$544 million for highways alone. If we factor in the needs for transit, intercity rail and multi-state freight improvements, the figures are just enormous.

This nation's Interstate System is at the end of its useful life. It cannot be repaired; it must be reconstructed and, in some areas, expanded to accommodate increased traffic. State governments must find funding.

In the 1950s, the federal government envisioned a national transportation system and funded it. States, in turn, constructed a first-class system. If the federal government had not paid the lion's

share of construction costs for the system, it would not have been built. States cannot create or fulfill that kind of vision on their own; nor can the private sector.

The federal government should continue to pay its share of at least 45 percent of the nation's highway system. At National Commission hearings, nearly every witness tells us the federal government's share should increase. I don't think P3s are a better value for the taxpayer and they won't fund an integrated national system. States are turning to the private sector because they do not want to ask taxpayers to pay more. The states sense the federal government may step away from its responsibility.

Some suggest that P3s could replace the federal responsibility. The purpose of this hearing is to explore how to protect the public sector interest in these deals should Congress agree with the promises of those who promote P3s. P3s come in many forms; my focus today is on the deals where a private sector organization, for all intents and purposes, controls a highway segment. The public sector negotiates a lease term and other conditions through a concession agreement. In turn, the private sector partner is responsible for operating the roadway, is held to certain performance standards, and collects tolls and other payments to gain a return on its investment.

**The public interest is different from the private interest and, in this case, it will be extremely difficult to assure a win-win solution.** The P3 model comes up short for Wisconsin. Wisconsin DOT partners with the private sector to design and construct its highways. But the public sector is held accountable for setting priorities, financing, managing, and providing oversight of the highways and other public assets. We have two fundamental decisions to make on transportation policy: First, can we responsibly delegate some or all of that accountability to the private sector? Second, if we can, how do we integrate the needs of the private sector into what has traditionally been a public sector system?

Some argue that the P3 model is an effort to harness the power of the market for the good of the public. But we come to the table with different interests, which need to be acknowledged and aligned for a project to succeed. Like any transaction, we need to ask whether we have enough information to get the best possible deal for the public. The private sector argues that we do. From what I have seen, I believe we do not.

**The private sector's legal responsibility to its shareholders is to make money – profit is their purpose.** The public sector's responsibility is to ensure that we make wise choices with

our citizens' resources: using them to build and maintain a system that supports regional and national economies, meets equity goals, has transparent financing, and supports other national efforts in the public interest. To do all of these things, we must negotiate a contract that aligns our stewardship responsibilities with the private sector's profit motives. This requires a reasonable amount of knowledge about the future, what is known and unknown, the range of possibilities.

Should states be allowed to enter into long-term leases of the Interstate or National Highways that sell off – or lease for several generations – a part of our national system to a private entity? Is this in our national interest? Faced with uncertainty about future needs and goals, the states will try to spell out every detail of the partnership. But there is too much that is unknown about demographic trends, technological development, pollution concerns, equity needs, future congestion, and safety innovations. No contract, no matter how effective, can eliminate risk. We do not know enough to price or manage such long-term risks.

Harnessing the profit motive to serve the public good is a worthy goal – one that would be worth supporting if we knew enough to ensure that profit would come from superior efficiencies in our national system. But in these contracts, we need to assure that profits are not coming from other sources, including:

- Cash flows generated by infrastructure investments made by government;
- Tolls, in excess of cost, that would otherwise be available to the government as revenue;
- Tax breaks to equity investors that reduce federal, state and local government revenue;
- Government guarantees of toll revenue streams;
- Deals that can be done because of government powers like eminent domain.

**The public has significant concerns with P3 deals. The public sector needs better tools to evaluate the deals and share that evaluation with the public.** It's not clear the deal in Indiana would happen if it were being considered today. Last news report I saw, half the citizens polled in New Jersey think the P3 approach to the Turnpike is not in their best interest. Why wouldn't we listen and consider the strong public reaction to these deals?

An underpinning of transportation project delivery is the public hearing process. Ideally, we would have perfect information to consider the long- and short-term costs and benefits associated with private and public sector approaches to projects that we could share with the public. Some countries have used public-private sector comparators to make these decisions.

Comparators can help public officials think through issues. We need to show the public what they will pay with the gas tax compared to what they will pay with private sector tolling. With this information, we could all make better decisions.

**P3s will likely not generate a predictable revenue stream that can replace the current federal share of the program.** The federal government can move national transportation policy in ways that states cannot. At least 45 percent of the revenues for our nation's system should continue to come from the federal government. With a renewed federal financial commitment to transportation, fewer states would need to consider P3s.

Why is federal funding in jeopardy? The federal gas tax provides most of the revenue stream for states' transportation grants. Congress has not increased the gas tax since 1991 and inflation has seriously eroded its purchasing power. At the same time, states are delivering more complex and expensive projects that must address all the human and environmental issues associated with a highway project.

SAFETEA-LU opened the door to tax incentives and tolling pilots. Some argue innovative finance should be expanded to offer the private sector a greater role. I have not seen any information that convinces me that P3s will replace the current federal revenue source. So is this really a discussion of whether the federal government's policy should be to hand transportation over to the states by slowly allowing federal gas tax revenues to dry up? I hope not. If we choose the path of continuing to reduce federal funds, I believe we will no longer have a national transportation system. Each state will act in its own interest.

**There will be considerable problems with integrating private sector financing with public sector policy goals.** Congress will need to consider many issues as they evaluate the P3 model.

- Will states that do not adopt tolling be left behind with no federal partner? Tolling only works when there is adequate VMT<sup>1</sup> on a roadway and there are no convenient, non-tolled highway routes that motorists can easily access. We have a large system of highways in our nation. Some states will not support tolls. Roads cannot be allowed to deteriorate if P3s are unacceptable to the citizens of some states.

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<sup>1</sup> Vehicle Miles Traveled

- Will federal policy penalize states that do not toll their systems? Already, many Federal Highway Administration (FHWA) discretionary programs include private sector investment as criteria for project selection.
- How will private sector partners be integrated into the current planning process for highway projects? Federal transportation authorization bills have created an interconnected system of planning for projects that includes state and local governments and other organizations. How will planning for our transportation system work in this new world of unsolicited bids? FHWA has employed a special experimental program, SEP-15, to deal with P3 questions related to federal requirements. This committee may wish to learn more about the SEP-15 program.
- Does Congress view federal tax expenditures for private sector projects as preferable to federal revenue increases for public sector projects? Most P3 deals have significant tax-shield benefits. Should federal tax expenditure benefits be more clearly stipulated in these deals so that the public can more easily consider whether a P3 or another revenue alternative makes better sense from the public's perspective?

#### **US DOT's Model Legislation**

The committee asked that I comment on US DOT's model legislation. The legislation is designed to give states the authority to enter into P3 agreements. Twenty-one states and Puerto Rico already have some legal ability to use P3s.

The intent of the model legislation is to establish a process for lawfully creating P3s. Based on our review, the legislation imposes no restrictions and creates no public protections. The ability to address and protect the public interest in P3 deals depends entirely on the skill with which states and municipalities negotiate contractual agreements.

The model legislation protects proprietary information contained in documents submitted by private entities submitting bids. These provisions conflict with strongly held Wisconsin values about openness and competition. These values are reflected in our state's open records and procurement laws that ensure transparency and encourage a robust and competitive bidding process.

The model legislation requires state DOTs to review unsolicited proposals within a certain timeframe. This provision puts investment consortiums in the position of bidding on any state highway asset, with states required to respond to all bids, solicited or unsolicited.

The P3 bidders are highly sophisticated consortiums, represented by large banks or investment firms. States will need advisors who are as well trained and experienced. States and municipalities are experienced in planning, designing and constructing projects; their strengths do not lie in the realm of high finance or long-term investment contracting. For states to negotiate on a level playing field, their P3 advisor budgets will necessarily become a significant sunk cost. Another concern is conflicts of interest with P3 advisors; P3 advisors should not advise states and those who bid on the projects.

Finally, the model legislation recommends state and/or local exemptions from property and other taxes. In addition to states and local governments losing potential toll revenues that could be invested in other projects, they are encouraged to give up other revenues.

**This committee will make critical choices that determine the outcome of this debate.**

While I know your Committee is interested in what state and local governments are doing, it is the federal questions that are the focus of your work. Ultimately, you will consider the recommendations of the National Commission and you will put together the policy direction for the next authorization bill. That bill may signal things to come.

I do not believe P3s are ready for prime time. These are only some of the P3 issues that deserve debate. In a supplement to this testimony, my staff has pulled together a list of policy questions that provides a starting point for the debate. My colleagues in state and local government need to be part of this national debate. I know that some of them will disagree with the ideas I have shared with this Committee. In my view, that is good. We have not yet had this debate from a national, system-wide perspective, and we need to.

I ask this Committee to engage in the P3 debate. **You are in the unique position to build the public record**, to detail what has worked well with the P3 deals, and to outline the key concerns that should be addressed at different levels of government. I fear that our P3 policies have evolved with little attention to their impacts. To simply say each state can do what it wants with the Interstate segments that lie within its borders is to bring into question the purpose of any federal role in transportation.

I have looked at the Clay Commission's report, calling for construction of the Interstate highway network. One of the most courageous elements of the 1950s highway legislation is that

it created a system that was accompanied by a federal commitment of federal funds – saying, in effect: This national system is in the best interest of the country and the federal government will pay for it, in partnership with states. That legislation was right for the time.

Today the role of the national transportation system is even more critical. Our businesses compete in global markets. Our nation needs an integrated freight transportation system. Our national security depends on rapid responses whether a crisis comes from outside or within our borders. We cannot risk having parts of the system fail. We cannot have a national system without a national vision and stable federal revenue stream. We must now have the policy debate that will help all of us – together – create the right transportation policy and financing for the next 50 years. Thank you for inviting me to testify today. I look forward to the policy discussions that lay ahead.



**Supplement**  
**To the Testimony of**  
**Frank J. Busalacchi, Secretary Wisconsin Department of Transportation**  
**Public Policy Issues Associated with Public Private Partnerships**  
**Questions for Study**

Any analysis of PPP models should address issues and questions associated with the appropriate use of PPPs and how to assure the public's interest in the delivery of services and management of the infrastructure. The following questions begin to outline some of the issues that should be addressed before determining how PPPs can play a role in the nation's transportation system:

**1. Are PPP agreements flexible enough to adapt to the changing objectives of different elected governments and the traveling public over the duration of the PPP agreement?**

- a. Transportation infrastructure is a valuable public asset. Should state governments establish guidelines for initial and long-term returns to private investors for their participation in a PPP to assure that the public's interest is protected? How would the public sector partner assess what a prudent long-term return would be for investments of 20, 30, 50, 75, or 100 years?
- b. Has there been competition in the bidding process with the U.S. PPP projects? What role have unsolicited bids played in the evolution of PPP deals in the U.S.? How can state governments be protected from private partner conflicts of interest?
- c. State governments typically work to improve the business climate within their borders. Should state governments be encouraged or discouraged from considering the impact of PPPs on competition among contractors bidding for transportation projects?
- d. In long-term concession agreements, what protections has the private sector incorporated to assure they are protected from the actions of future legislative bodies that may receive political pressure to reduce tolls that are perceived as too high?<sup>2</sup>
- e. What grounds are sufficient for terminating a PPP agreement? What has been the experience thus far in contracts negotiated in the U.S.? Should there be overarching guidance for states on issues to address in the concession agreements?

**2. Have policy makers adequately assessed the benefits of PPPs to date, specifically the contract elements that have been effective in protecting the public sector interest?**

- a. Could state governments ever allow a private sector partner to face bankruptcy? Would the state have recourse to the assets of its private partner or a parent company of the partner, or should the state serve as an "investor" of last resort for an inefficient or undercapitalized PPP?

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<sup>2</sup> The change from Conservative to Liberal rule in Ontario resulted in many efforts to rescind or change the lease. The Indiana Toll Road lease specifically provides the concessionaire "quiet possession and enjoyment" of the toll road.

- b. Should state governments play a role in the corporate governance of a private partner after a PPP agreement has been signed? Is this realistic, and from the public's perspective, is this desirable?
- c. How can the state, acting in the public's interest, be sure it has not under-priced its assets prior to entering into a concession with a private partner? What actions have states taken to assure the accurate valuation of their assets?
- d. Concession agreements reached in the U.S. have been longer (50 + years) than those typically seen in Europe and Asia (20 to 30 years). Is it prudent to extend a contract out 50, 75 or 100 years in order to obtain a large amount of cash upfront? Would it be better to issue several contracts for a shorter length of time and, possibly, engage different entities as partners? Are there other reasons for the issuance of longer contracts in the U.S.?
- e. What problems can state governments expect to encounter when interpreting the differences in costs between a PPP project and a wholly government-sponsored project? Have states analyzed the positives and negatives associated with a state-administered toll facility and a privately leased toll facility?<sup>3</sup> Has any methodology been used in the concession evaluations to date?
- f. Are PPPs fiscally responsible when taking into consideration all factors such as state and federal tax treatment, lump-sum payments, and the reassignment of long-term revenue streams?
- g. How does the public sector assure that contracts between the public and private sectors are adequately exposed to government sunshine laws and at the same time respecting the private sector's need for shielding proprietary information?

3. What considerations should be given to the intergovernmental relationship when addressing policy associated with the use of the PPP approach to financing our transportation system?

- a. If state governments are negotiating independently with the private sector to design, build, rehabilitate, and operate separate pieces of a national highway system, how will the separate pieces of the system be integrated to comport with federal highway requirements and overarching national system goals? What about regional and local goals? Should MPOs or affected local governments be part of the PPP negotiations?
- b. From a national perspective, will potential concessionaires "cherry-pick" facilities with great profit opportunity leaving other less traveled facilities in more remote areas of the country to rely only upon federal payments to improve their systems?
- c. There is a dispute between the private sector concessionaire and local volunteer EMS providers who seek to charge the concessionaire for responding to crashes and other emergencies on the toll road. How will emergency services be paid for on leased toll ways?

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<sup>3</sup> Methodologies include: British National Audit Office report on: "A Framework for Evaluating the Implementation of Private Finance Initiative projects: Volumes 1 and 2", May 2006 and Services Industries Branch, Industry Canada, "The Public Sector Comparator: A Canadian Best Practice Guide", May 2003,  
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- d. Should the federal government lay out requirements for state governments to address in their PPP projects, or should the federal government take a laissez faire attitude and leave complete discretion to the state governments?
- e. Should private sector partners and public-privates sector deals be given preferential treatment by US DOT, both in process and financing areas?
- f. Should there be federal incentives to states to look at PPP options for project financing? Some have suggested that projects over \$50 million should consider the PPP option. In addition, it has been suggested that states be allowed to argue a *de minimus* federal financial involvement in a project to avoid federal requirements that attach to traditionally financed federal-aid highway projects.
- g. What branch of government should bear responsibility for authorizing PPP agreements with a private partner or terminating a PPP agreement? If the facility is part of the “national interest,” should that affect the ability of states to enter into these agreements?

4. Should state governments develop and retain the in-house expertise necessary to monitor, inspect and evaluate private partner performance? Or is contracting for analysis of private partner performance preferable to using in-house resources?

- a. What has been the experience of state and local governments negotiating these deals? Have some states relied on contracted experts while others have relied on in-house advice? Has this made any difference in the quality of the contracts?
- b. When using contracted experts, how can conflicts of interest be avoided? Should firms that provide investment and expertise on these deals be able to bid on projects?
- c. What has been the experience of states with administrative costs – including legal, financial, management and other advisors and consultant fees – associated with their PPP projects? How much should states expect to pay for all the studies and financing expertise that are associated with a PPP project?

5. What interests of state government and the traveling public are served by granting so-called “non-compete” clauses to private sector partners as part of a DBFO agreement?

- a. What are the potential positive and negative impacts, to the public sector, of non-compete agreements in concession agreements? How have non-compete clauses been established in U.S. PPP agreements?
- b. Have non-compete clauses been a standard part of PPP contracts in other countries? If yes, is there longer-term experience with their impact on future transportation decision-making?

## **Principles**

Once the analysis of the issues above is completed, the Commission could develop a simple set of principles for their use in discussing and evaluating potential Public-Private Partnership (PPP) models. The principles could include:

- The principle of **equity** could require that PPP project financing (tolls) reflect the proportion of a traveler's use of, impact on, and benefit from a transportation facility, while not placing a more regressive financial impact on users than traditional forms of transportation finance.
- The principle of **efficiency** could require that PPP arrangements deliver lower costs with less bureaucracy than traditional transportation arrangements.
- The principle of **adequacy** could require that PPP arrangements have sufficient revenue, financial reserves and contract flexibility to meet the reasonable, predictable, short and long-term needs of the traveling public.
- The principle of **transparency** could require that all PPP arrangements, including contract language and provisions, be simple, straightforward, and open to public scrutiny, monitoring and evaluation. In addition, transparency would address the extent to which the elements of a PPP contract could be shared with elected officials and the public.
- Another relevant principle could be a demonstrable level of **public acceptability** for a particular PPP arrangement.
- The principle of **system integration** promotes the evaluation of how the PPP approach to financing infrastructure addresses the goals and needs of an integrated national transportation system